No. 87-198[illegible]

In The

Supreme Court of the United States

October Term, 1987

UNITED STATES OF AMERICA,

Petitioner,

v.

PHILIP GEORGE STUART, SR.,
AND MONS KAPOOR,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF OF RESPONDENTS

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STATEMENT OF THE CASE

Philip George Stuart, Sr. and Mons Kapoor are Canadian citizens and taxpayers, residing in the Province of British Columbia. They received notice that the Internal Revenue Service ("IRS") had issued and served summonses on the Northwestern Commercial Bank in Bellingham, Washington at the request of the Department of National Revenue, Canada ("Revenue Canada") seeking production of records regarding their financial transactions.[1] The IRS was not claiming or investigating any United States tax liability. (J.A. p. 19, par. 6; p. 23, par. 6 (Stuart); CR 1, par. 6; CR 5, par. 6 (Kapoor)). Stuart and Kapoor commenced proceedings under 26 U.S.C. § 7609(b)(2) to quash the summonses. The Northwestern Commercial Bank was notified by counsel for Kapoor and Stuart of the pendency of those proceedings and instructed, pursuant to 26 U.S.C. § 7609(d), not to produce any records unless a court order directing it to do so was obtained.

The petitions to quash challenged the enforcement of the summonses on the grounds that they were not issued for a lawful purpose, did not seek information relevant to any inquiry concerning an internal revenue tax of the United States, and that the information could be requested directly under applicable Canadian statutes and regula-

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[1] Stuart and Kapoor also received notice that the IRS had issued summonses to another third-party recordkeeper located in the Western District of Washington. Petitions challenging those summonses were filed. The petitions were dismissed as moot after the IRS withdrew those summonses.

tions.[2] The petitions also alleged that since the summonses were not issued for a lawful purpose, the IRS had therefore failed to follow the required administrative procedures.

After receiving the IRS' responses to their petitions to quash, Stuart and Kapoor each served a set of interrogatories on the IRS consisting of six questions seeking limited discovery concerning the criminal nature of Revenue Canada's investigation. (J.A. pp. 38-40.) The IRS refused to provide any discovery responses whatsoever stating that Revenue Canada's letter request for an exchange of information was considered "secret" and that the IRS does not allow its own counsel, much less a party challenging a summons, access to such information. (J.A. pp. 34, 35.)

At the same time it filed its objections to providing any discovery, the IRS filed motions for summary enforcement of the summonses. The Affidavits of Thomas J. Clancey, Director of the IRS Foreign Operations District, disclosed that "[t]he Canadian taxing authorities' investigation of [the petitioner] is a criminal investigation, preliminary stage." (J.A. p. 27, par. 2) This disclosure of the criminal nature of Revenue Canada's investigation made the need for the discovery sought by Stuart and Kapoor even more acute. Stuart and Kapoor filed

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2 Stuart's petition also alleged, on the basis of information and belief, that the IRS had failed to give him proper notice under 26 U.S.C. § 7609(a)(1) and that the summons was therefore unenforceable. Subsequently, Stuart learned that notice had been properly given and this objection was withdrawn during oral argument on the IRS' motion for summary enforcement of the summonses.

memoranda in opposition to the IRS' motions for summary enforcement.

As both proceedings had previously been referred to Magistrate John L. Weinberg pursuant to 28 U.S.C. § 636 (b)(1) and Magistrate's Rule 4(a), Local Rules of the Western District of Washington, Magistrate Weinberg heard oral argument on both summary enforcement motions at a single hearing on July 27, 1984. No evidentiary hearing was held at that time or later, the motions being determined on the basis of the pleadings and records then on file.

On September 30, 1985, Magistrate Weinberg's Report and Recommendation recommending enforcement was filed in the Stuart proceeding. The same Report and Recommendation was filed the next day in the Kapoor proceeding. Stuart and Kapoor filed objections to the reports pursuant to Magistrate's Rule 4(c), Local Rules of the Western District of Washington. In addition to renewing the objections made in their memoranda opposing the motions for summary enforcement, Stuart and Kapoor raised the issue of whether the Convention Respecting Double Taxation, March 4, 1942, United States-Canada, 56 Stat. 1399, T.S. No. 983 (as amended) ("1942 Treaty") or the Convention with Respect to Taxes on Income and on Capital, September 26, 1980, United States-Canada, *reprinted in* 1 Tax Treaties (CCH) ¶ 1301 (1984), controlled enforcement of the summonses. Stuart's and Kapoor's objections to the Magistrate's Report also requested an opportunity to pursue discovery regarding the equivalency of Revenue Canada's "criminal investigation, preliminary stage" to a referral to the United States Department of Justice. (C.R. No. 25 (Stuart); C.R. No. 17 (Kapoor).)

The two United States District Court judges to whom the petitions had been originally assigned each adopted the Magistrate's Report and Recommendation without modification. In neither case was the Magistrate's Report and Recommendation nor the district court's order adopting it and ordering enforcement reported. Notices of appeal were timely filed in each case. The United States Court of Appeals for the Ninth Circuit consolidated the two appeals and, on the motion of Kapoor and Stuart, stayed enforcement of the summonses pending the outcome of the appeals. The appeals were argued and submitted on December 4, 1986. The court's opinion was filed on March 24, 1987 and is reported at 813 F.2d 243.

The court of appeals held that since the 1942 Treaty was in force at the dates when both the request for exchange of information was made by Revenue Canada and when the IRS made its decision to honor that request, that Treaty rather than the 1980 Treaty, which was in effect at the time the district court's enforcement orders were entered, would control. The court rejected the government's argument that the decision by the IRS to honor a treaty request was a political question not properly reviewed by the courts. The court's analysis was based on *Baker v. Carr,* 369 U.S. 186 (1962). The court of appeals then examined the merits of the lack of good faith objection to enforcement raised by Stuart and Kapoor under *United States v. Powell,* 379 U.S. 48 (1964). The court held that the good faith requirement applied in the Treaty request context. Noting the impact of Internal Revenue Code § 7602(b)-(c), enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), and which

established a "bright line" test, the Court declined to follow the pre-TEFRA decision of *United States v. Manufacturers & Traders Trust Co.,* 703 F.2d 47 (2nd Cir. 1983). The court held that it was the government's burden to show a lack of an analogous referral in order to establish its prima facie case for enforcement, reasoning that such an approach avoided the anomaly of recognizing a defense to enforcement and then denying the taxpayer access to the information needed to establish the defense. Finally, the court rejected the unilateral post-argument submission of materials by the IRS, which materials the government argued established the lack of an analogous referral by Revenue Canada.

The United States petitioned the court of appeals for a rehearing with a suggestion for a rehearing en banc. That petition was denied. On December 24, 1987, following an extension of time, a petition for a writ of certiorari was filed by the United States. Certiorari was granted on May 2, 1988.

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SUMMARY OF ARGUMENT

A. The judicial analysis necessary to determine a challenge to the enforcement of a summons issued at the request of a Tax Treaty partner is not the type of inquiry barred by the political question doctrine. *See Baker v. Carr,* 369 U.S. 186 (1962); *Goldwater v. Carter,* 444 U.S. 996 (1979). While the executive branch is given the responsibility to make treaties and to conduct the foreign relations of the United States, the Constitution does not

charge the executive branch with the sole responsibility to interpret treaties nor with the enforcement of their provisions utilizing domestic law. The "bright line" test adopted by the court of appeals below to determine the existence of the good faith prerequisite to summons enforcement established in *United States v. Powell,* 379 U.S. 48 (1964) does not involve an inquiry beyond the normal scope of judicial experience or expertise. Finally, the court's interest in preventing an abuse of its process, which process must be used to enforce summonses, overrides any modest prudential concerns that may be implicated by such an inquiry.

B. The 1942 Treaty describes the information the IRS may obtain and exchange as that which it is "in a position to obtain under its revenue laws" (Art. XIX) or as the "Commissioner [of the IRS] is entitled to obtain under the revenue laws of the United States of America." (Art. XXI) The legislative history of the 1942 Treaty does not disclose any intention or expectation on the part of the contracting nations that requests made pursuant to the information exchange provisions would not be subject to United States statutory and decisional law. A defense to summonses enforcement based on a level of criminal prosecutorial involvement has been established both by decisional law (*United States v. Powell, supra*) and statutory law (IRC § 7602(c)). It is both reasonable and logical to apply that aspect of the "revenue laws" of the United States to treaty summons enforcement. To limit the good faith inquiry to the IRS' activities, as the government argues, would be meaningless where, as here, no United States tax liability is at issue. The foreign referral requirement discussed in the *Stuart* opinion is

a practical, non-burdensome test that will foster uniform results in enforcement proceedings while avoiding the need to examine the changing interplay of civil and criminal investigation and prosecution under foreign law.

C. Treaty summons enforcement proceedings should be summary in nature. The burden of proof required of the government to establish its prima facie case for enforcement is slight. The government has ready access to the information necessary to enable its competent authority to make the required averments regarding lack of an analogous referral by Revenue Canada. If the foreign referral or good faith requirement were to remain solely an affirmative defense in treaty enforcement proceedings, it would be necessary to expand the now severely restricted scope of discovery available to parties challenging enforcement. Such an expansion would be necessary to prevent the unfair anomaly of recognizing a defense to enforcement, but denying access to the information necessary to establish that defense.

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ARGUMENT

I. The Political Question Doctrine Does Not Bar this Court from Determining the Availability and Applicability of the Good Faith Restriction on Tax Treaty Summons Enforcement

In *Baker v. Carr,* 369 U.S. 186 (1962), this court undertook a survey of its earlier political question decisions in an effort to define the contours of that doctrine prior to applying it in that voting rights case. One of the rubrics

under which the case law was examined was "foreign relations." After noting that sweeping statements regarding the exclusivity of the executive's prerogative in the conduct of foreign relations abounded, the court went on to observe:

> Yet, it is error to suppose that every case or controversy which touches foreign relations lies beyond judicial cognizance. Our cases in this field seem invariably to show a discriminating analysis of the particular question posed, in terms of the history of its management by the political branches, of its susceptibility to judicial handling in the light of its nature and posture in the specific case, and the possible consequences of judicial action.

Baker v. Carr, supra, 369 U.S. at 211.

The plurality opinion by Justice Powell in *Goldwater v. Carter,* 444 U.S. 996, 998 (1979) distilled the factors identified for consideration in *Baker v. Carr* down to three inquiries:

> [1] Does the issue involve resolution of questions committed by the text of the Constitution to a coordinate branch of Government?
>
> [2] Would resolution of the question demand that a court move beyond areas of judicial expertise?
>
> [3] Do prudential considerations counsel against judicial intervention?

The circumstances surrounding the enforcement of the Stuart and Kapoor summonses dictate negative answers to all three of these questions.

First, while Article II, Section 2 of the Constitution authorizes the President to make treaties with the advice and consent of the Senate, there is no similar textual, constitutional provision making the executive branch the sole arbiter of controversies arising under those treaties. Just the opposite is true. The courts created under Article III of the Constitution are charged with the power to determine cases or controversies, including those arising under the treaties of the United States. U.S. Const. Art. III, § 2; 28 U.S.C. § 1331.

Second, there is no "lack of judicially discoverable and management standards for resolving" the challenges raised by appellants; nor is a decision impossible "without an initial policy determination of a kind clearly for nonjudicial discretion." *See Baker v. Carr, supra,* 369 U.S. at 217. Treaty interpretation is a well-recognized role of the judicial branch. *See, e.g. Kolovrat v. Oregon,* 366 U.S. 187 (1961); *Perkins v. Elg,* 307 U.S. 325 (1939); *United States v. Decker,* 600 F.2d 733 (9th Cir. 1979), *cert. denied,* 444 U.S. 855 (1979).

In *Decker* the government argued that the decision to approve regulations promulgated by the International Pacific Salmon Fisheries Commission, which commission was established pursuant to a treaty between the United States and Canada, was an exercise of the executive branch's foreign affairs prerogative. Therefore, the decision was not subject to judicial scrutiny. The court of appeals held that it was not barred by the political question doctrine from reviewing the appellants' criminal convictions based on a violation of those regulations, stating:

> In those few cases involving interpretation of treaties when the political question doctrine precludes review, that doctrine has narrow confines. The principal area

> of nonjusticiability concerns the right of the executive to abrogate a treaty. (citations and footnote omitted)

United States v. Decker, supra, 600 F.2d at 737.

The challenges to summons enforcement raised by Stuart and Kapoor concern treaty interpretation, search and seizure constraints, enforcement of administrative summonses and the scope of allowable discovery in proceedings to challenge those summonses. All of these topics are regular concerns of the courts and are areas in which substantial case law already exists.

Third, prudential concerns do not require that this court refuse to review the propriety of the enforcement of summonses directed to a domestic bank, which enforcement is being challenged under a statute specifically providing for review. While the documents, if obtained, would ultimately be forwarded to Canadian authorities, it can hardly be expected that the propriety of the acquisition of those documents by the IRS is not a proper subject for judicial review. The enforcement of the summonses must rely on the courts' process and the courts may not allow that process to be abused. *United States v. Powell,* 379 U.S. 48, 58 (1964).

A decision to leave the "competent authority's" determination to force the production of documents essentially unreviewable in the treaty summons context would be to abdicate responsibility for guarding against abuses of the court's process.

II. The Good Faith Requirement for Tax Treaty Summons Enforcement Is Established by the 1942 Treaty and by United States Revenue Law

The relevant portions of the two articles of the 1942 Treaty regarding information exchange requests provide as follows:

> *Article XIX*
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> With a view to the prevention of fiscal evasion, each of the contracting States undertakes to furnish to the other contracting State, as provided in the succeeding Articles of this Convention, the information which its competent authorities have at their disposal or are in a position to *obtain under its revenue laws* in so far as such information may be of use to the authorities of the other contracting State in the assessment of the taxes to which this Convention relates.
>
> • • •
>
> *Article XXI*
>
> 1. If the Minister [of the Department of National Revenue] in the determination of the income tax liability of any person under any of the revenue laws of Canada deems it necessary to secure the cooperation of the Commissioner [of the IRS], the Commissioner may, upon request, furnish the Minister such information bearing upon the matter as the Commission *is entitled to obtain under the revenue laws of the United States of America.*

1942 Treaty, Art. XIX, ¶ 1 and Art. XXI, ¶ 1 (emphasis added).

The interpretation of a treaty must begin with its language. The clear import of the treaty language controls unless such application will cause a result that is clearly at odds with the intention of the parties to the treaty. *Sumitomo Shoji America, Inc. v. Avagliano,* 457

U.S. 176, 180 (1982) (citing *Maximov v. United States,* 373 U.S. 49, 54 (1963)). The clear import of Articles XIX and XXI is that the Revenue Canada cannot expect to receive and the IRS cannot expect to obtain or provide information in a fashion inconsistent with United States summons enforcement law. The use of the foreign referral test proposed by the *Stuart* opinion below would not interfere with the treaty parties' intention to prevent fiscal evasion. In fact, the government has already argued that it can meet that test under the facts of these cases. *Stuart,* 813 F.2d at 250.

The legislative history offered by the government as an aid to interpretation of the 1942 Treaty discloses no more than the expectation that the information exchange provisions would allow one country to request the other to provide it with information for use in an investigation by the requesting country of its citizens' tax liability. *See* Brief of the United States, p. 29, footnote 11. Such legislative history does not require this court to ignore the plain language of Articles XIX and XXI, which must remain the focus of interpretation. *See e.g. S & E Contractors, Inc. v. United States,* 406 U.S. 1, 13 n.9 (1972). There is nothing in the legislative history to suggest that either Canada or the United States expected that the IRS would be freed from the need to employ process of court to enforce summonses issued pursuant to the Treaty; nor that in doing so, a court would be powerless to prevent abuses of its process. *See United States v. Powell,* 379 U.S. 48, 58 (1964).

Prior to passage of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Public Law No. 97-248, 96 Stat. 324 (1982), an "institutional bad faith" defense to summons enforcement had been recognized by the courts and had been the focus of considerable concern. *See United States v. LaSalle Nat'l Bank,* 437 U.S. 298 (1978)[3]; *Donaldson v. United States,* 400 U.S. 517 (1971). In an effort to streamline summons enforcement proceedings, the courts have also severely restricted a taxpayer's right to seek discovery of facts to challenge the government's prima facie case. *See, e.g. United States v. Church of Scientology,* 520 F.2d 818 (9th Cir. 1975); *United States v. Samuels, Kramer and Co.,* 712 F.2d 1342 (9th Cir. 1983). The *Stuart* majority opinion affirms the application of this aspect of "judicial gloss" to foreign tax treaty summons enforcement.

Stuart and Kapoor found themselves in a particularly unfair situation as a result. On the one hand, the affidavits submitted by the government disclose that the records sought were for use in a "criminal investigation, preliminary stage," (J.A. p. 28) which they argued raised "sufficient doubt" about the lack of civil purpose, which civil purpose has been held by one court of appeals to be a prerequisite to use of the 1942 Treaty's information exchange provision. *United States v. Samuels, Kramer and Co., supra,* 712 F.2d at 1348. On the other hand, the limited

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[3] As noted in the Brief for the United States at page 17, IRC Section 7602(c) adopted the *LaSalle* minority's suggestion for a "bright-line" test for meeting the *Powell* good faith requirement.

discovery rule prevented them from developing a complete record.

As the *Stuart* opinion noted, the affidavits submitted by the government in support of motions for summary enforcement of a domestic summons sometimes affirmatively attest to the lack of such referral. *Stuart supra,* 813 F.2d at 250. In a domestic summons enforcement case, lack of a referral for criminal prosecution might reasonably be inferred from an enforcement officer's affidavit attesting that: (1) all proper administrative steps for issuance of the summons had been followed, and (2) the summons was issued for a legitimate purpose. This is not so in the tax treaty summons context.

While the two policy considerations identified in *United States v. LaSalle Nat'l Bank,* 437 U.S. 298 (1978), *i.e.,* a desire not to broaden the discovery available to the Justice Department in criminal litigation and a desire not to infringe on the role of the grand jury, are not directly impacted in the tax treaty summons context, there is still strong justification for applying *Powell's* good faith requirement. One such reason is to provide for a uniform test for summons enforcement. If there was any United States tax liability being investigated simultaneously by the IRS through the use of an administrative summons, there is no doubt that Stuart and Kapoor would be afforded the same protection provided by the grand jury as United States citizens despite their Canadian citizenship and residence. *See, e.g., Wong Wing v. United States,* 163 U.S. 228 (1896). This is consistent with the extension to aliens of other constitutional rights once considered the prerogative only of the United States citizens. *See, e.g., Yick Wo v.*

Hopkins, 118 U.S. 356 (1886); *Takaheshi v. Fish and Game Comm.,* 334 U.S. 410 (1948). Uniform standards in summons enforcement proceedings ought to be the rule absent significant justification for discrimination. Uniformity of treatment is and ought to remain a hallmark of our judicial system.

Another justification for interpreting the language of the 1942 Treaty to include a good faith requirement is that the requirement articulated in the *Stuart* opinion can be easily applied. In its petition for rehearing with a suggestion for rehearing en banc directed to the Court of Appeals for the Ninth Circuit, the government argued that the foreign referral test was a "practical impossibility." Petition for Rehearing, p. 15, footnote 8. The test articulated in the *Stuart* opinion is straightforward and does not deserve such characterization. That test simply requests an answer to the following two questions:

> (1) Has Revenue Canada recommended that the Canadian Department of Justice criminally prosecute [the taxpayer]? or
>
> (2) Has Revenue Canada requested the summons at the behest of the Canadian Department of Justice?

Stuart, supra, 813 F.2d at 249. Moreover, as the *Stuart* opinion noted the government submitted materials which it argued proved that there had been no referral by Revenue Canada analogous to a referral to the Justice Department. *Stuart, supra,* 813 F.2d at 250.

The foreign referral test articulated by the *Stuart* majority opinion avoids a potentially difficult inquiry into the status of Canadian procedural law. All the IRS need

do to establish the good faith element of its prima facie case for enforcement is to attest that both of the questions set forth above have been answered in the negative. Having once done so, any party challenging enforcement would be required to present facts sufficient to call into question the validity of those assertions before it would be allowed any discovery or an evidentiary hearing. There would be no need to examine the changing relationship between the newly enacted Canadian Constitution and Bill of Rights with criminal and civil tax investigation and procedure.[4] *See* Appellant's Joint Brief, pp. 18-21.

The government argues that only the good faith of the IRS should be at issue in a treaty summons enforcement proceeding. While the good faith of the IRS may be a proper area of inquiry, it ought not to be the sole area of inquiry. Where, as here, there is no United States tax liability at issue, such an inquiry is pointless as a practical matter.

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[4] The Brief for the United States notes that there are 33 other countries with which the United States currently has in force income tax treaties containing exchange of information provisions. Brief for the United States, p. 41, footnote 7. The government notes that none of those countries currently employ grand juries. There is, of course, no guarantee that a grand jury or similar body will not be employed in the future in those countries. The foreign referral test articulated in the *Stuart* opinion obviates the need to examine or re-examine the status of any of our treaty partners' law in that regard, instead substituting a test based on our revenue laws.

III. The Lack of Foreign Referral Requirement Should Be an Element of the Prima Facie Case for Summons Enforcement in Order to Preserve the Summary Nature of those Proceedings

If the good faith requirement is going to be of any practical importance in the Tax Treaty enforcement setting, then that defense or rather the negation of what would otherwise be a defense, ought to be made an element of the government's prima facie case for enforcement. Under normal circumstances, the burden of establishing a defense rests on the party asserting that defense. However, perhaps in light of ill-founded "tax protestor" challenges to summons enforcement, the courts have denied discovery to the party challenging the summons absent that party's ability to present specific facts calling into serious question the government's prima facie case. *See United States v. Samuels, Kramer and Co.*, 712 F.2d 1342, 1347-1348 (9th Cir. 1983); *United States v. Church of Scientology*, 520 F.2d 818, 823-824 (9th Cir. 1975).

Stuart and Kapoor are not tax protestors, but are nonetheless restricted by that same line of authority from engaging in discovery designed to elicit the facts necessary to establish the lack of good faith. By shifting the initial burden to the government to show a lack of analogous foreign referral, the court:

> avoids the anomaly of "placing a burden of proof upon the taxpayer and then denying access to what may be the very information needed to meet that burden."

Stuart, supra, 813 F.2d at 250 (citing *United States v. Stuckey*, 646 F.2d 1369, 1373-74 (9th Cir. 1981) *cert. denied sub nom. Weinstein v. U.S.*, 455 U.S. 942 (1982)).

Any concern about unwarranted interference in the relations between the United States and Canada are best served by avoiding the need for discovery in treaty summons enforcement proceedings. Presumably, on remand, the United States would file additional affidavits to answer in the negative, the questions posed in the *Stuart* opinion. Unless Stuart and Kapoor could challenge those new affidavits with facts already in their possession, the summonses would be enforced. It is highly unlikely that such a procedure would seriously jeopardize the foreign relations between the United States and Canada, two countries who have so many other more important contractual and commercial relations.[5]

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CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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September 1988

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5 One knowledgeable commentator has estimated that the U.S. competent authority makes and receives as few as 200 such requests per year under the bilateral tax treaties. Guttentag, "Exchange of Information Under Tax Conventions," *ALI-ABA Course of Study: Income Tax Treaties,* 245 at 250 (1982).